

Independent Rates Oversight Committee – IROC
SPECIAL WORKSHOP

November 8, 2010
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1. Roll Call

Chairperson Peugh brought the Workshop meeting to order at 8:01 a.m. Monica Foster called the roll and a quorum was declared. Attendance is reflected below:

Member	Present	Absent
Jim Peugh, Chair	X	
Don Billings	X	
Tony Collins	X	
Christopher Dull	X	
Andy Hollingworth	X	
Jack Kubota	X	
Irene Stallard-Rodriguez	X	
Todd Webster	X	
Gail Welch	X	
ExOfficios		
Augie Caires, Metro JPA (<i>arrived at 8:40</i>)	X	
Ken Williams, City 10	X	

2. Staff Presentation on Financial Planning Factors and Rate Setting Drivers

Alex Ruiz, Assistant Director, Public Utilities, provided copies of the presentation and began by thanking IROC for attending this Workshop, which he indicated will give a strategic overview and is important to discuss the framework for the Department's financial planning and rate case setting process in this type of forum. He added he will be looking forward to getting feedback from the members and looking forward to future workshops on key issues.

He referred to his presentation by outlining the meeting goals also reviewing the data and discussion framework. He noted the various key drivers associated with financial planning efforts, Rate Case considerations, and the decision milestones. He pointed out a series of integrated decision making processes that are produced before the IROC, seeking balanced and timely evaluations. These include annual financial reviews, as well as rate adjustments and debt financings.

Next, he gave a description of the decision making process. He described a typical order of events which would start with a Department request, then to the Department/Mayoral for approval, to the IROC and/or Metro JPA Committee(s) for support, then to Council Committee, followed by Council and their authority to execute, and finally, implementation. He noted any of these processes can return back to the pre-existing review, keeping in mind with Council's schedules and recesses, etc. can take longer than usual.

He described the financial planning as a needs-based approach for enterprise fund cost and recovery planning. He summarized the key goals and added there are

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multiple drivers that factor into the total evaluation of Rate Case recommendations. He pointed out the variety of drivers involved in a Rate Case, referring to diagrams. The important drivers discussed today would be: CIP program needs, CIP financing, followed by rate affordability; public confidence, and Operations and Maintenance needs, which must be run as competitive and as efficiently as we possibly can in order to keep rates down. He added there would be other items of course, but these 5 drivers are the point of focus.

Mr. Ruiz began with the CIP program needs, which include the repair and replacement program, regulatory requirements, customer demands, and supply development. He then described the distribution of expenditures and pointed out data contained in the provided Table 7 compiled earlier this year, an excerpt from the most recent Official Statement (OS). This was the summary of projected CIP projects for FY10 through 2014. He reminded the IROC this past Spring, the Master Planning Initiative was brought before IROC, which took in consideration the facility conditions and system deficiencies in order to determine project needs. He then pointed out the prioritization criteria.

He distributed a detailed chart of the forecasted Water CIP Program Draft, which covered a 20 year look ahead starting in FY11 and going through FY30. He then reviewed the CIP financing. He gave an overview of the recent bond experience, mentioning the \$141 million bond refunding.

He went over line items on provided detailed charts (Table 18 from OS) of Estimated Operating Revenue and Expenses FY10-FY14. He noted there was a question from the media, which was, “what would happen if we had to absorb the \$25 million pass-through coming up?” He then referred to a second revised chart of Table 18, showing absorbing the \$25,177 million in pass-through increases. After describing the line items, and pointing out the changes to the debt coverage ratio percentages, he noted by 2013/14 we would be at the threshold for coverage ratios. He then described the all in debt, and concluded with by FY12, we would be in violation of our Bond covenants carry a maximum of 1.0 total all in debt coverage ratio for Net System Revenues. Committee Member Hollingworth asked about the Reserve levels. He added there are reserves from the Rate Stabilization Fund (one time revenue source) as well as the second Pass-through Rate Increase coming up, which are not included in this scenario.

Next, he discussed rate affordability, and included a detailed chart on a summary of Water and Wastewater rates and fees to a typical single family dwelling customer, from FY06 through FY11, not including the pass-through increases. He also provided an Agency comparison of water rates. The City of San Diego falls about 6th highest in the region.

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Committee Member Billings noted there needs to be a longer term view to understand the approximate 10% increase per annum is a catch up investment program. He added it is important to know that had the City been able to Bond Fund when it was out of the market, and to invest in a more measured study way, this could be a much lower nominal per year. Mr. Ruiz indicated in future discussion we can include a Rate Case projection going back to the early 1990, when there were no rate increases at all. This would give the larger picture, and he added this is part of the CIP Master Planning discussion.

He then mentioned the Rate Affordability with USEPA Index and the current economy. He added that we work with a variety of stakeholders and serve a large community, so public confidence, communication, trust and transparency are very important to us. The Department will be stepping up the communication efforts to push communication and openness, and displayed various fact sheets put out to the community. He also referred to slides listing the numerous current oversight framework we are engaged in.

Next, he gave an overview of the Operations and Maintenance (O&M) FY2011 Water Fund Budget (\$425M) and details. He summarized the expenses for Personnel expenses and committed expenditures, after the minus of these, resulted in a Total Budget of \$74.3 million. He noted this amount is basically used to pay for motive equipment, fuel, other maintenance activities, as-needed engineering contracts, and so forth.

Committee Member Welch asked, in regard to the water purchasing being the bulk of the costs to the budget, do the recycled water and the Purple Pipe take into account less water we would have to purchase for wholesale use? Mr. Ruiz indicated this is just the total water purchases on the potable side. He said this does offset the cost when we can use recycled water opposed to purchasing water. She asked if Mr. Ruiz could give an update later, on the cost of service studies in this regard, he concurred.

He then discussed the 5-year planning with O&M, stating this also involves our Strategic Planning, Performance Metrics, Budgetary Goals and Objectives and Bid-to-Goal. We have a goal to reduce our overall O&M by another 10% going into FY12. This was an internal goal we set, because we realize there will be upward pressure on rates driven by external factors. We must demonstrate that we understand we must keep costs down, as well as keeping the public's confidence high. We keep the Plan, Implement, Monitor, and Respond cycle going, to make sure we are continually improving each year.

Mr. Ruiz referred to a detailed chart, summarizing all of the Rate Case Drivers, and how they play a part. He then touched on the decision milestones coming up. He talked about the market's creating a great deal of discipline, and Committee

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Member Billings concurred and feels that is an extremely important point that the discipline on the entire process put in place by the bond markets is very significant and we should keep this in mind.

Committee Member Hollingworth commented that with his analysis of the economics of this industry, a large portion of the cost structure is out of one's control. He referred to the CWA and the MWD rates, and believes the oversight of the two was not very effective in trying to control the pass through costs, with the 3 CWA Board members not agreeing with this year's budget, and it was passed anyhow. He asked if the Department has addressed this. Mr. Ruiz stated outside public testimony, he does not have standing to engage their staff directly. He added there are regular briefings, however, with 2 representatives that serve on the CWA and MWD Boards, and receive these updates monthly. He added, it is still difficult for them to have leverage. He reminded Mr. Hollingworth, our relationship is with the CWA, and asking them to look hard, at their CIP program.

In conclusion, Mr. Ruiz pointed out the anticipated rate adjustments. To answer Committee Member Welch's inquiry earlier, one of the drivers we are looking at, is what is the "burn rate" for existing Bond Proceeds and when can we go back to the market for additional Bonds, and how long this will last. When this timing is right, we will be able to look at when the next rate increase needs to be calibrated for. At that point, our Cost of Service Study on the Water side will be backed up to provide the data necessary to support that prospective increase. It is all in the timing and the reliability of CIP, financials and planning of O&M.

In regard to the Recycled Water Study, a Draft has been received from the Raftelis Group. We are looking forward to that discussion starting in January.

Ex-Officio Member Williams raised a question regarding Debt Coverage (referred to page 20 of the handouts – Table 18 absorbing the pass-through increases), what kind of rates would be necessary to make these debt coverage ratios fit, and have you taken this approach? Mr. Ruiz, (and Chris Ojeda), indicated the pass-through results in approximately 4.4%. He added we did not take this approach, being consistent with FY08 and FY09. Committee Member Williams asked if it is fair to say if we do not increase the rates, come 2013/14 to have a coverage ratio of .8 is not the best scenario. Mr. Ruiz stated we are covenanted to raise rates to sustain the 1.0 coverage.

Committee Member Billings commented that there are other factors as well, and he finds compelling that the Public Utilities Department has to provide water on demand at an amount they want subject to supply constraints, and to provide it EPA standards, bringing it from a great distance. He added this is a big promise and is delivered to the average household for approximately \$2.36 per day, is very impressive. He believes when we talk about rates and increases, it will never be

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at a zero cost, or even at \$2. He does feel however, there is a discipline in the form of credit ratings and what the Bond Market requires, and the Bid-to-Goal program which is supported by IROC.

He also added he feels in respect to all of this, in the media, some believe this is all about pension costs. He pointed out this Department does not determine what the annual pension contribution is, so this Department cannot change this, and the public needs to understand this. The trend in fringe is driven not by a massively increasing menu of benefits, but is driven by the fact that prior Council's did not fund the plan, and the market was unfavorable in recent years, and the Mayor decided to pay the mortgage off in 15 years instead of 20 or 30, all of these things contribute to driving up the fringe.

Secondly, he added he would like to see some trend lines, going back over a whole investment cycle, where we would have been had the Department not made the FTE cuts, or had not put in place the various efficiency savings, etc. He feels it is very important for the public to understand that the baseline represents a great deal of cost cutting already. Also, a scenario analysis if the economy was to recover at a faster rate.

Committee Member Hollingworth indicated he would like to have a policy discussion with the Department to address the policy issue for the next 2 years, if reserves were drawn down to mitigate a rate increase with the intent to help the local economy, what would be the pros and cons of doing this. Mr. Ruiz indicated this can be done, as both a Sewer and Water fund, since the DRES on the Sewer side is not able to be used for Water offset.

Mr. Ruiz asked the IROC in addition to Committee Members Billings and Hollingworth's requests, for any other comments, requests, or follow-up for a future meeting. He would like to discuss future rate increases, so IROC is in full understanding of all inputs and trade-offs we present to you. He wants to be as detailed and as effective in communicating as possible.

Chairperson Peugh indicated he would like to understand how dollars map into actual work performed. Committee Member Billings concurred, and added he would like to see a deferred maintenance metric and deferred CIP metric based on actual vs. optimized, which would make it easier to understand if we are on track. Chairperson Peugh would like to see spreadsheets regarding risks to revenue as well. Mr. Ruiz took note of this.

Ex-Officio Williams complimented Mr. Ruiz on a great presentation, and his suggestions were to go into further detail of the coverage rate ratio, which is a crucial piece, having a target. Also, he indicated projecting rate increases that could occur over the next 5 years would be helpful.

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Committee Member Webster requested information not only on the forecasted Water CIP Program, but on the Wastewater side due to the Waiver issue. Chairperson Peugh asked in regard to the Less than 2% Affordability figures, for both Water and Wastewater. Mr. Ruiz indicated he does not have this information with him, but can be provided later.

Chairperson Peugh asked if there would be a separate rate case for IPR? Mr. Ruiz stated, it is there for at least 3 years, and the costs are unknown at that time. The Rate case we would be preparing would not have these cost incorporated, with the unknown formal decision, as the Demonstration Project has not been run. The monies available at this time are to support the Demonstration Project. Costs are not yet planned for within a going forward Rate Case. He added there are many costly elements to this Project, and the decision moving forward on this will have to take that into account at that time. Chairperson Peugh indicated there should be more analysis on the planning for future costs of this Project. Chairperson Billings added, to clarify for Chairperson Peugh, this type of analysis would require going beyond a 5-year Rate Case as the payoff will be in further years as imported water gets more expensive. Mr. Ruiz noted what would be clear in the going forward Rate Case, is the CIP Projects included in that Rate Case, and this will all be discussed with IROC.

3. IROC Members' Comments

Tom Zeleny, Deputy City Attorney, commented on the use of DRES funds with regard to Prop 218. He indicated this was not legislation; it was done by an initiative. In his opinion, it is not drafted properly, and includes vague statements and ambiguities. His understanding with the use of DRES funds that they are mainly savings from CIP Projects to the extent the funds in the DRES can be traced back to our rate increases pursuant to Prop 218, and to the extent this money will be used for construction. It cannot be switched for offsetting future price increases on the cost of water, for example. This money maintains that dedicated characteristic. If the funds are not used for that dedicated purpose, it must be returned.

Chairperson Kubota asked Mr. Ruiz, in the listed Customer Demands and Sustainable Growth Long Term Reductions in the CIP Program, with the new developments with regard to water needs, are there implications to build onto existing facilities to accommodate? Mr. Ruiz indicated the CIP planning efforts incorporate growth for the region, the treatment plants are expanded, for example.

Committee Member Kubota added the importance of communicating that when there are broken pipes, and water is not being delivered to an area for sometime, that fire hydrants are also at risk of not being available in the case of an emergency fire situation. Mr. Ruiz appreciated his comment and urges the IROC

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to get familiar with the cost of funding not only the cast iron pipes, but also the transmission mains, and dedication to ground water and new supply development.

Committee Member Hollingworth referred to Table 18 in the handouts, which was very helpful, and suggested in the future, using a base forecast and sensitivity analysis based upon certain changes. Mr. Ruiz concurred.

Public Comment

A speaker slip was received. Chairperson Peugh invited Mr. Clark Dawson, City of San Diego resident, to speak. Mr. Dawson asked Mr. Zeleny if the 218 construction sequestration be allowed to be used for construction of cast iron pipe replacement. Mr. Zeleny stated it depends on the language in the 218 Notice, he stated he would have to review the Notice, but is a fair assumption it would be for construction related activity for the Water Department.

Mr. Dawson then commended Mr. Ruiz for a wonderful presentation, and suggested a helpful tool would be to add other water classes to the scenario, being a water bill payer of the City, he feels it would be beneficial to see what impacts it would be on commercial, industrial and irrigation rate classes. For example, an actual dollar rate rather than a typical bill. Mr. Ruiz appreciated the comments.

Adjournment of IROC

At approximately 9:56 Chairperson Peugh adjourned the meeting.

Recording Secretary: _____
Monica Foster